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No. 223

In the

Supreme Court of the United States

OCTOBER TERM, 1968

JAMES MAHONEY, ET AL.,

Petitioners,

vs.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION,

Respondent.

PETITIONERS' REPLY TO MEMORANDUM OF RESPONDENT

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Our petition raises the question whether the right to federal savings and loan insurance is governed by federal or by state law. The decision below applies state law. The petition contends that federal law should govern, citing the statute itself, (Pet. 9-10) a flood of case authority (Pet. 11-12) and the need for national uniformity. (Pet. 12-13). Because of the enormous importance of the savings and loan industry in our economy, the question, we think, deserves an authoritative answer from this Court.

1. *Federal law controls.* FSLIC avoids response to this central issue with the claim (FSLIC p5) "The court

of appeals simply held that controlling federal law looks to state law as delineating the identity of an entity (such as a joint tenancy) claiming membership in the insured financial institution." This "delineation" distinction we submit is an FSLIC invention. The authorities we cited (Pet. 11-12) do not distinguish between the substantive law applicable to a federal issue and a "delineation" of the sphere of applicability of the federal enactment. The distinction—if accepted—would work endless mischief for it would engender a gossamer of case law casuistry as to whether an issue was "substantive" (and hence controlled by federal law) or a question of "delineation" (to which state law applied). The fact is that "delineation" is itself a federal question: e.g., the scope of a federal land grant (*Hughes* v. *Washington,* 389 U.S. 290, 19 L Ed.2d. 530 (1968) (Pet. 12); the "sale" of natural gas in interstate commerce (*United Gas Improve Co.* v. *Continental Oil Co.,* 381 U.S. 392 (1965) (Pet. 11); the tax definition of "partnership" (*Commissioner* v. *Culbertson,* 337 U.S. 733 (1949) (Pet. 15). Under the Securities Exchange Act of 1934 the question whether withdrawal capital shares in a savings and loan association constitutes a "security" for purposes of the Act is itself a federal question. *Tcherepnin* v. *Knight,* 389 U.S. 332, 19 L.Ed. 2d 564, 570 (1968).

FSLIC reliance upon several cases in this Court is misplaced (FSLIC p. 5). In *RFC* v. *Beaver County,* 328 U.S. 204, a federal statute authorized states to tax real property held by an RFC agency "to the same extent according to its value as other real property is taxed." The holding of this Court relied upon this language as authority to depart from the usual rule that federal statutes are to be given a uniform national interpretation. *U.S.* v. *Cambridge Loan and Building Co.,* 278 U.S. 55, no longer appears to be good law. See *Commissioner*

v. *Culbertson*, 337 U.S. 733, 93 L. Ed. 1659 (1949). In *DeSylva* (FSLIC p. 5), the question was whether an illegitimate child was a "child" entitled to exercise a copyright renewal. Under local law, he was and that law was applied. There it appeared that application of local law effectuated federal policy. But even so, Justices Douglas and Black, in a separate opinion, 351 U.S. at 583, commenting on this very point, expressed the view that the question should be settled as a federal matter.

We rested our claim for the applicability of federal law, not only on the cases at Pet. 11-12 but also on the text of the National Housing Act, and especially on a 1966 amendment to the statute (Pet. 10). FSLIC answers (FSLIC p. 8, n. 16) that the amendment was designed only to confirm the FSLIC right to remove cases from a state to a federal court, citing S. Rept. No. 1482, 89th Cong., 2d Sess. p. 19 (1966).

This answer is wholly inaccurate. The relevant section, Sec. 1730 (k) (1) has three subsections. Subsection C does indeed authorize removal, and S. Rept. 1482 so notes. But we rely on Subsection B. (Pet. 10). As to this, the Report states:

> "(B) provide[s] that any action to which the Corporation shall be a party shall be deemed to arise under the laws of the United States and that the United States district courts shall have original jurisdiction of such actions, without regard to the amount in controversy, ..."

The conclusion is inescapable that our interpretation of "B" is correct. It does "signal" the "applicability of federal substantive law" to FSLIC litigation. (cf. FSLIC p. 8, n. 16).

2. *FSLIC raises a specious claim of "administrative construction"*. FSLIC claims that the ruling of the court

below applying state law is supported by "the long-standing administrative construction of the act." (FSLIC p. 6). This assertion is wholly lacking in merit. The administrative construction rule applies only to public pronouncements of an agency.[1]

What does FSLIC (FSLIC p. 7) serve up in support of its "long standing administrative construction?" Without authorization, FSLIC included in its Court of Appeals appendix a 1937 article in the Federal Home Loan Bank Review, an intra-office memorandum, and 12 items of private correspondence, dating to the 1930's. We moved that these documents be stricken. The Court of Appeals stated that the letters "apparently have not been given any public circulation" (Pet. 10a) and added that it disregarded them in its consideration. Yet FSLIC now feels impelled again to rely on these letters, even though not one was ever published as agency policy. Unearthing these documents is not an exercise in administrative construction. It is rather exhumation of the administrative necropolis.

3. *The accounts were validly insured as partnership accounts under FSLIC regulations.* In our petition (Pet. 15) we pointed out that FSLIC Reg. Sec. 561-3, here applicable, created the term "account held jointly" to embrace all forms of co-ownership accounts, not just

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[1] E.g., in *U.S.* v. *Leslie Salt Co.*, 350 U.S. 383, 100 L.Ed. 441 (1946). (Published Treasury Decisions). *Udall* v. *Tallman*, 380 U.S. 1, 13 L.Ed. 2d 616 (1965) makes the very point—it speaks of an interpretation made a "matter of public record" (380 U.S. at 4). In *Edward's Lessee* v. *Darby*, 25 U.S. (12 Wheat.) 210, 6 L. Ed. 603, it was a public survey of lands around salt licks and salt springs. In *Norwegian Nitrogen Products* v. *U.S.*, 288 U.S. 294 at 313, 77 L.Ed. 796 (1933), the practice was reported to Congress. In *Masur* v. *Stein*, 347 U.S. 201, 212, 98 L.Ed. 630, the administrative practice was set out in the Federal Register.

technical state law joint tenancies, and provided that such accounts were insured as an insured account held by a partnership. It is not disputed that a validly insured partnership account needs only the signature of one partner. One studying the regulation would surely conclude that one signature sufficed, and would scarcely foresee that, after default, FSLIC would, in the face of its own regulation and in the face of the FSLIC approved "one signature only" legend on the signature card, import state law concepts to avoid liability.

We so argued at Pet. 15-16. FSLIC contents itself with a footnote summary of Reg. 561.3. (FSLIC p. 4, n. 8). Thus FSLIC, which now urges that "delineation" is a state law question, itself delineated, as a federal matter, the area of "accounts held jointly" and declared the applicable substantive (partnership) rule applicable to them.

4. *The new regulations magnify, not diminish, the need of review.* FSLIC calls attention to FSLIC regulations, effective September 1, 1967, requiring each co-owner to sign a signature card. It urges that hence there is thus "an independent federal requisite" that will eliminate for the future the question raised by petitioners. On the contrary the new regulation accentuates the underlying issue of the case—whether federal or state law controls. A joint account valid as such under the law of a State which does not require all joint owners to sign a signature card (cf. *Connor,* FSLIC p. 6), under the new regulations, is no longer valid as a joint account for FSLIC insurance purposes. We think the new federal regulations requiring signature of all co-owners is valid, but the holding below casts grave doubt on their validity. Under that holding, State law and State law only controls.

There are other areas of the new regulations under a similar cloud. Thus the insurance accorded associations,

partnerships and corporations under the new regulations depends upon whether or not they are engaged in an "independent activity", an FSLIC created term. We think this provision too is valid, but the thrust of the decision casts grave doubt upon it, and thus renders uncertain the scope of federal insurance. There are other provisions in the regulations which specifically override state law concepts, invent new concepts and impose rules utterly out of harmony with state law.

FSLIC seeks to justify the new regulations by a 1966 amendment to the statute (FSLIC p. 8 n. 17). We anticipated this contention. (Pet. 13), pointing out that the 1966 amendment grants no new substantive power to FSLIC. Since 1934 FSLIC and its parent, the Federal Home Loan Bank Board, has had general rule making power and has exercised this power for decades. See, as an example, the very definition of "insured member" and "insured account" at Pet. 3.

5. *The accounts are insured under FSLIC long standing policy determinations of the National Housing Act.* Our final contention (Pet. 19-23) is that petitioners' accounts are insured in the light of FSLIC's long-standing policy determinations respecting the National Housing Act stemming from its awareness of the industry assertions, year after year, in every medium of communication, that "accounts" in their institutions were insured to $10,000 by FSLIC. We need not speculate as to FSLIC knowledge of industry claims, because one of the most telling examples was FSLIC approved: Every page of every Marshall passbook (the form of which was FSLIC approved) bore a legend "Safety of your savings insured up to $10,000.00". These words were encircled by the phrase "Federal Savings and Loan Insurance Corporation". Would not a depositor given such a passbook think that the account it represented, apart from

any other accounts he had in the institution, was insured to $10,000? Twenty months after Marshall failed, FSLIC (and FDIC) for the first time took public note of the misleading character of these claims and compelled the institutions to modify their advertising practices. FSLIC (p. 6, n. 13) takes note of the joint statement but fails to point out that it was made nearly *two years* after Marshall failed.

Based upon the facts we contend that the Court below erroneously relied upon this Court's decision in *Federal Crop Insurance* v. *Merrill,* 332 U.S. 380 (1947) (Pet. 19). The scope of that doctrine, in light of the facts at bar, we think warrants review here.

FSLIC takes cognizance of these contentions, simply in a line or two in a footnote (See FSLIC p. 8, n. 17). We think our claims, affecting as they do millions of savings and loan investors, merit review here.

Respectfully submitted,

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